Supreme Court, U.S.
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No. 03-0314 42

IN THE

Supreme Court of the United States

EAGLE INSURANCE COMPANY and
NEWARK INSURANCE COMPANY,

Petitioners,

v.

BANKVEST CAPITAL CORP.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED FOR REVIEW

Does 11 U.S.C. § 365(b)(2)(D) allow a bankruptcy trustee or debtor in possession to assume an executory contract or unexpired lease without curing or providing adequate assurance that it will cure **any** existing nonmonetary defaults?

LIST OF INTERESTED PARTIES

Petitioners:

Eagle Insurance Company

Newark Insurance Company

Respondent:

Bankvest Capital Corp.

Other Interested Parties:

Finova Loan Administration, Inc.

CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 29.6, Petitioners, by and through their undersigned attorneys, hereby disclose that:

1. Newark Insurance Company ("Newark") is a nongovernmental corporate party and is a wholly owned subsidiary of Appellant, Eagle Insurance Company ("Eagle"). No publicly held corporation owns 10% or more of Newark's stock.

2. Eagle is a nongovernmental corporate party and is a wholly owned subsidiary of The Robert Plan Corporation ("Robert Plan"). No publicly held corporation owns 10% or more of Eagle's or Robert Plan's stock.

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STATEMENT OF JURISDICTION

This appeal arises out of a final order of the United States Bankruptcy Court for the District of Massachusetts, entered on December 12, 2001, denying the requests of Eagle Insurance Company ("Eagle") and Newark Insurance Company ("Newark") for the payment of cure costs pursuant to Section 365 of the Bankruptcy Code, a final order of the United States Bankruptcy Appellate Panel for the First Circuit, dated March 28, 2003, affirming the decision of the Bankruptcy Court, and a final order of the United States Court of Appeals for the First Circuit, dated March 15, 2004, affirming the decision of the Bankruptcy Appellate Panel. This Court has jurisdiction over this matter pursuant to 28 U.S.C. § 1254(1).

STATUTE INVOLVED

§ 365. Executory contracts and unexpired leases

> (a) Except as provided in sections 765 and 766 of this title and in subsections (b), (c), and (d) of this section, the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor.

(b)(1) If there has been a default in an executory contract or unexpired lease of the debtor, the trustee may not assume such contract or lease unless, at the time of assumption of such contract or lease, the trustee –

(A) cures, or provides adequate assurance that the trustee will promptly cure, such default;

(B) compensates, or provides adequate assurance that the trustee will promptly compensate, a party other than the debtor to such contract or lease, for any actual pecuniary loss to such party resulting from such default; and

(C) provides adequate assurance of future performance under such contract or lease.

(2) Paragraph (1) of this subsection does not apply to a default that is a breach of a provision relating to –

(A) the insolvency or financial condition of the debtor at any time before the closing of the case;

(B) the commencement of a case under this title;

> (C) the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement; or
>
> (D) the satisfaction of any penalty rate or provision relating to a default arising from any failure by the debtor to perform nonmonetary obligations under the executory contract or unexpired lease.

11 U.S.C. § 365(a), (b)(1), (b)(2).

STATEMENT OF THE CASE

A. Introduction

Many, if not most, of the executory contracts faced by the bankruptcy courts contain significant nonmonetary provisions. Licenses, leases, and other contracts involving the temporary or partial transfer of rights, in particular, all contain provisions that do not directly relate to the payment of money but are essential components of the commercial transaction. Section 365 represents a calibrated balancing of the rights of the parties to executory contracts. This Court in *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 79 L. Ed. 2d 482, 104 S. Ct. 1188 (1984) has, indeed, recognized that in a chapter 11 case, the rights of the debtor to be given a chance to reorganize are balanced against the interests of its creditors and their contractual rights. Unfortunately, as a result of the decision of the United States Court of Appeals for the First Circuit in this case, there is now an irreconcilable conflict in the circuits as to the interpretation of that

provision, dramatically shifting the balance that was adopted by the Ninth Circuit and throwing the bankruptcy courts into doubt and confusion. It is both appropriate and necessary for this Court to elucidate the meaning of this core provision of the Bankruptcy Code to further the intent of the legislation.

B. Procedural History

This appeal arises out of requests for the payment of cure costs (the "Cure Claims") filed by Eagle and Newark pursuant to the Fifth Amended Joint Liquidating Plan of Reorganization of the Debtor and the Official Committee of Unsecured Creditors (the "Plan") of BankVest Capital Corporation (the "Debtor" or "BankVest"), confirmed by the Bankruptcy Court on May 31, 2001. The Plan required that all parties to executory contracts and unexpired leases with the Debtor file their requests for payment of cure costs on or before the effective date (the "Effective Date") of the Plan. Eagle and Newark both filed timely Cure Claims, alleging claims based on BankVest's failure to deliver equipment under equipment leases in which BankVest was the lessor.

On August 15, 2001, Finova Loan Administration, Inc. ("Finova"), on behalf of the Debtor,[1] objected to the Cure Claims. On August 16, 2001, the Bankruptcy Court issued an order requiring the parties to submit memoranda of law on the issue of whether the claims of Eagle and Newark were "cure claims or something else." After receiving memoranda

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1. The Debtor and Finova entered into a stipulation, filed with the Bankruptcy Court on or about August 6, 2001, whereby Finova agreed to assume the Debtor's responsibility to defend the cure claims asserted by Eagle and Newark.

of law, the Bankruptcy Court held a non-evidentiary hearing on November 7, 2001. On December 12, 2001, the Bankruptcy Court entered a final order in which it concluded that Eagle and Newark have no cure claims that must be satisfied before the Debtor can assume and assign the Leases since the claims asserted by Eagle and Newark were based on nonmonetary defaults. The Bankruptcy Court concluded that § 365(b)(2)(D) provided an exception from the requirement in § 365(b)(1) that the trustee or debtor in possession cure all defaults upon the assumption of an executory contract or unexpired lease and concluded that that exception encompassed ***all*** nonmonetary defaults. In so doing, it adopted the interpretation of § 365(b)(2)(D) "that penalty rate obligation and a nonmonetary default are two separate types of breaches which a debtor is not required to cure prior to assumption of contract." App. 40a. It concluded, therefore, that BankVest is not required to cure its defaults prior to assumption nor provide adequate assurance that it would cure the defaults. At best, Eagle and Newark only had damage claims that might be asserted in a separate proceeding.

On December 21, 2001, Eagle and Newark filed timely notices of appeal to the United States Bankruptcy Appellate Panel for the First Circuit. After reviewing the extant cases, and with little further analysis, the Bankruptcy Appellate Panel, on March 28, 2003, entered judgment affirming the decision of the Bankruptcy Court. On April 16, 2003, Eagle and Newark filed timely a notice of appeal to the United States Court of Appeals for the First Circuit. The First Circuit affirmed on March 15, 2004, expressly rejecting the Ninth Circuit's decision in *In re Claremont Acquisition Corp.*, 113 F.3d 1029 (9th Cir. 1997) (the relevant portions of which are attached as Appendix D), which supported the position of Eagle and Newark.

C. Statement of Facts

For the purposes of this petition, the underlying facts, which the Bankruptcy Court assumed were true, are undisputed.[2] On or about May 27, 1999, Eagle and Newark entered into separate Master Equipment Lease Agreements (the "Eagle Lease" and the "Newark Lease" respectively, or collectively the "Leases") with the Debtor, pursuant to which Eagle and Newark were to lease from the Debtor approximately 190 pieces of computer equipment (the "Equipment") over a period of 48 months. App. 2a-3a. The rent payments under the Eagle Lease were $11,940.61 per month, and the rent payments under the Newark Lease were $10,111.82 per month. App. 3a.

At the time the Leases were entered into, each of the parties involved, including the Debtor, knew that the Debtor's vendor, Nortel, had not manufactured approximately 20 items of the Equipment. Therefore, Eagle and Newark made an arrangement with Nortel for the short-term loan of equipment with lesser capacity and intelligence, to hold them over until the new equipment was manufactured. The other leased items were delivered at or about the same time. Notably, the loaned items constituted the most critical components of the leased Equipment and accounted for 60 percent of the entire value of the leased goods.[3] App. 3a.

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2. While the court's decision was not a result of a motion to dismiss for failure to state a claim, it was akin to one. No evidence was taken in this case.

3. As an example, one of the items not delivered was an 8 Port Gig Module, whose value for a single unit was $13,311.00. Contrast this with the ***eleven*** Baystack 400-SRC Cascade Return Cables that were delivered and whose ***total*** value was $1,287.00.

On December 17, 1999, before BankVest had completed delivery of the Equipment and paid for any of it, an involuntary bankruptcy petition was filed against BankVest. No additional Equipment was delivered after the involuntary petition was filed. As a result, Eagle and Newark never received a substantial portion of the Equipment that the Debtor agreed to lease to them.[4] The failure to deliver the Equipment formed the basis of Eagle's and Newark's Cure Claims.

On June 15, 2001, Eagle and Newark filed their Cure Claims. In the Cure Claims, Eagle and Newark asserted that the Debtor's breaches of the Leases were such that they could not be cured. To the extent that the breaches could be cured, however, Eagle and Newark sought damages caused by the Debtor's failure to deliver a substantial portion of the Equipment. App. 5a-6a. Finova, on behalf of the Debtor, objected to the Cure Claims alleging that the claims do not relate to any outstanding obligations of the Debtor and that Eagle and Newark were merely seeking to preempt a lawsuit against them to collect outstanding lease payments.

Following a non-evidentiary hearing, the Bankruptcy Court held that Eagle and Newark do not have "cure claims

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4. BankVest has characterized Eagle's and Newark's position as a claim that the Equipment was "nonconforming." While Eagle and Newark disagree with this characterization, it is irrelevant for purposes of this petition. Whether the Equipment would be deemed to be nonconforming or not delivered, the distinction did not play into the decisions of any of the courts below. The courts held that all nonmonetary defaults, ***no matter what the type***, are excluded from § 365(b)(1)'s requirement that defaults be cured upon the assumption of an executory contract or unexpired lease.

to be satisfied before assumption and assignment of the leases." App. 40a. The Bankruptcy Court's decision assumes that the Debtor is in default and holds that, despite such defaults, the Debtor need not cure them as a condition to assumption of the Leases, something that is normally required by § 365(b)(1) of the Bankruptcy Code. App. 40a. The Bankruptcy Court held that § 365(b)(1)'s requirement that defaults be cured in connection with an assumption of an unexpired lease does not apply when the defaults are nonmonetary, no matter whether the default is central to the lease or merely incidental and no matter whether the remedy sought is compensatory or punitive. Holding that the failure to deliver the Equipment under the Leases constituted nonmonetary defaults, the Court concluded that the Debtor could assume the leases without delivering the Equipment or even providing adequate assurance that it would deliver it. *Id.* The Bankruptcy Appellate Panel agreed and affirmed. App. 30a-31a. The United States Court of Appeals for the First Circuit affirmed, expressly rejecting the Ninth Circuit's holding in *In re Claremont Acquisition Corp.*, *supra*.

REASONS FOR GRANTING THE PETITION

I. There Is Direct Conflict Between the Circuits

Unlike many of the cases that seek a writ of certiorari, this case presents a patent and unambiguous conflict between the circuits. As the First Circuit in the opening paragraph of its decision stated:

> The Ninth Circuit, in the only court of appeals opinion to address this question, held that non-monetary defaults must be cured before

> assumption *In re Claremont Acquisition Corp.*, 113 F.3d 1029, 1034-35 (9th Cir. 1997). In the proceedings below, the bankruptcy court and the Bankruptcy Appellate Panel (BAP) reached the opposite conclusion. **We disagree with the Ninth Circuit** and affirm.

App. at 2a (emphasis added).

There are now at least two – and arguably three – interpretations of § 365(b)(2)(D) that have been articulated by the courts. The first was set forth by the Ninth Circuit in *Claremont* (the relevant portions of which are attached as Appendix D). Under the Ninth Circuit's reading, the word "penalty" applies both to the word "rate" and to the word "provision". As the First Circuit explained, "[o]n [the *Claremont* court's] reading, Congress intended subsection (D) to read like this:

> (D) the satisfaction of any penalty rate [, or any penalty provision] relating to a default arising from any failure by the debtor to perform nonmonetary obligations under the executory contract or unexpired lease.

App. at 9a-10a. This reading was also accepted by *In re Williams*, 299 B.R. 684, 686 (Bankr. S. D. Ga. 2003); *In re New Breed Realty Enters.*, 278 B.R. 314, 320 (Bankr. E.D.N.Y. 2002); and *In re Vitanza*, No. 98-19611DWS, 1998 WL 808629 at *21 n.44 (Bankr. E.D. Pa. Nov. 13, 1998). Under this exegesis, the focus of the section is on the concept of a "penalty." Whether the penalty is embodied in a monetary rate or a nonmonetary consequence or event, subsection (D) only applies if the court finds some punitive consequence in

requiring the debtor to comply with the contractual provision. If the provision is not punitive, then the trustee or debtor in possession must cure the problem before assuming the contract. Inherent in this approach is the notion that there is a panoply of nonmonetary provisions (performance obligations) that are essential to the executory contract, which Congress intended that the trustee or debtor in possession perform if it wants to reap the benefits thereof.

In contrast, the First Circuit asserted that the word "penalty" describes only the term "rate" and that, therefore, the second half of subsection (D) creates an entirely distinct and independent exception for failure to perform nonmonetary obligations. The paragraph would then be read:

> (D) the satisfaction of any penalty rate [, or any] provision relating to a default arising from any failure by the debtor to perform nonmonetary obligations under the executory contract or unexpired lease.

App. at 10a. Following this line of analysis are *In re Walden Ridge Dev., LLC*, 292 B.R. 58, 67 and n.2 (Bankr. D.N.J. 2003); *In re W. Pac. Airlines, Inc.*, 219 B.R. 298, 304 (Bankr. D. Colo.) *rev'd on other grounds*, 219 B.R. 305 (D. Colo. 1998); and *In re GP Express Airlines, Inc.*, 200 B.R. 222, 233-34 (Bankr. D. Neb. 1996). This approach sees two different ideas comprised by subsection (D). First, the trustee or debtor in possession need not cure punitive rates imposed by a contract – for example, a penalty rate of interest on unpaid obligations. Second, and independently, the First Circuit reading would allow trustees or debtors in possession to assume a contract without curing nonmonetary defaults of any kind, whether punitive or not. In the complex

world of leasing and licensing, nonmonetary obligations encompass most of the terms of contracts and leases executed in the marketplace.

These two positions cannot be reconciled. Either the exception to the cure requirement is limited to penalties, whether they relate to monetary rates or nonmonetary obligations, or it creates two entirely unrelated exceptions – one for penalty rates and the other for all nonmonetary obligations, including the most commercially reasonable ones. Nor does either reading result from a commercial arrangement unique to this particular case. Instead, both purport to be decisions of general applicability and have since been argued or relied on as such. *See, e.g.*, *In re Williams*, 299 B.R. 684 (Bankr. S.D. Ga. 2003) (citing the *BankVest* Bankruptcy Appellate Panel decision), *In re Walden Ridge Development, LLC*, *supra* (citing the *BankVest* Bankruptcy Court decision).

II. The Conflict Will Not Easily Be Resolved Without Supreme Court Determination

There are several reasons that a proper – or even uniform – interpretation of § 365(b)(2)(D) will not come about without intervention by this Court. The fundamental problem is that the statutory provision in question – § 365(b)(2)(D) – is poorly worded. The court below observed that "[n]othing in the language or syntax of § 365(b)(2)(D) unambiguously requires either outcome." App. at 11a. The Ninth Circuit was more attracted to a grammatical analysis, but engaged in such parsing only because the face of the statute lacked clarity. There is no reason to believe that, in the absence of this Court's direction, future circuit decisions will have any tendency to coalesce based on additional textual refinement.

As noted earlier, a number of bankruptcy courts have lined up on both sides of the issue, with no additional light having been shed on the problem.

Indeed, it is far from clear that *Claremont* and *BankVest* have exhausted the possible readings of the subsection. The Fourth Circuit has offered, *en passant*, an arguably different explanation, when it stated, "Recent amendments also provide that the landlord may not charge the debtor the default rate of interest under the contract or lease when the default with which the debtor is charged is nonmonetary in nature." *In re Shanga-La, Inc.*, 167 F.3d 843, 848 n.3 (4th Cir. 1999). While not entirely clear, this reading of the subsection, seemingly ties "default rate" and nonmonetary default together in a way that excludes from the cure requirement nonmonetary – but punitive – default provisions but ***requires*** the cure of punitive rates where the underlying default is monetary.

Yet another explanation – and perhaps the best explanation – not yet adopted in a published opinion, begins with the introductory language of subparagraph (2), which provides that subparagraph (1) of the subsection "does not apply to a default that is a breach of a provision ***relating to*** . . ." (emphasis added) either of the possibilities set forth in subsection (D). Neither the First, Fourth, or Ninth Circuit's interpretation explains the function of the highlighted language in the context of a nonmonetary default, nor do any of the bankruptcy court decisions on this topic discuss that issue. The use of the phrase "relating to" in the introductory language may be read – and, the petitioners believe, should be read – to protect debtors from satisfying provisions that impose a derivative penalty that is a consequence of a nonmonetary default while still requiring

the cure of the underlying nonmonetary default itself. This reaches a similar result to the *Claremont* court, but gives meaning to all the words of the statute and avoids the practical problems set forth by the First Circuit. For example, if a licensee is subject to a "use" provision that limits the scope of its ability to use certain technology – a common patent licensing provision – and violation of that provision triggers liquidated damages of $10,000 per day, § 365(b)(2) would require the debtor to cease violation of the use provision (that is, the provision relating to default of a nonmonetary obligation specified in subsection (2)(D)) but permit assumption without payment of the liquidated damages clause (the provision relating to the provision relating to the default of a nonmonetary obligation specified in subsection (2)). Similarly, a clause providing for a forfeiture in the event of a breach of the same use provision might not be enforceable, yet the trustee or debtor in possession might still have to correct the underlying default by bringing the use in conformance with the license agreement.

As a result, the issue is not one that will eventually accrue a majority of circuits on one side or another and, thereby, converge on one interpretation. Instead, the courts are most likely to fractionalize into multiple overlapping or conflicting readings, no one of which will garner consensus.

Second, although there is some legislative history on the provision in question, it is scant at best. *See Claremont* at 1034, App. at 53a (Ninth Circuit notes "limited legislative history"). Indeed, the First Circuit found it to be without any value. App. at 12a ("legislative history of § 365(b)(2)(D) is not instructive."). Thus, to the extent that the courts can, in general, rely on legislative history to decipher ambiguous language, it has already been rejected by the First Circuit

and therefore is unlikely to contribute to a harmonization of the future understanding of the subsection.

Third, neither the Ninth Circuit's reading of the statute nor the First Circuit's are entirely satisfactory; each interpretation creates its own set of problems. The First Circuit chose to highlight the problems with the Ninth Circuit's interpretation of the statute but totally ignored the problems with its own interpretation, as well as some important policy reasons why such interpretation is incorrect. At least part of the difficulty arises from the multiple goals and focuses of the Bankruptcy Code. Unlike many statutes that have a narrow and explicit purpose, the Bankruptcy Code embodies a spectrum of concerns, values, objectives, and core precepts. This balancing of interests not only pervades the Code in general, it is inherent in § 365 itself, as recognized by this Court in *NLRB v. Bildisco & Bildisco*, *supra*, discussed at page 15-16, *infra*. In the absence of a polestar purpose that can be used to guide the interpretation of problematic sections, any given circuit panel or district judge will have different impulses depending on their individual reactions to the multipolar balancing implicit in the section. As a result, the outcome will vary not only according to the circuit, but even to the particular panel that considers the matter. Put another way, the First Circuit's exegesis of the statutory language and bankruptcy policy – and particularly its spotlight on the issue of "historical facts" is not without any merit, but ultimately is neither conclusive nor necessarily suasive to other courts.

In the absence of definitive interpretation by this Court, the split among the federal courts will only fester and worsen.

III. The Issue Relates to Fundamental Statutory Interpretation and Congressional Intent

At issue is the interpretation of a federal statute that can and should be applied uniformly throughout the United States. The provision in question is at the heart of the bankruptcy process. Section 365 has application in almost every corporate reorganization under Chapter 11 and every business bankruptcy case under Chapter 7, often with profound implications for the estate and the other participants. Thus, this Court has a significant interest in providing a definitive construction of the terms of part of the Bankruptcy Code, one of the most pervasive and detailed exercises of federal legislation. Whatever the conclusion the Court reaches, all parties to contracts will be able to adjust their commercial expectations in a uniform and consistent way. It is not fair to anyone to have conflicting outcomes of such a basic issue result from unresolved and antagonistic understanding of federal law.

Further, the matter requires the determination of significant issues of congressional intent in the absence of clear linguistic or legislative history guideposts. Section 365 represents a calibration and balancing of complex and potentially conflicting rights and obligations. This Court has stated that the ultimate goal of Chapter 11 is to promote a successful reorganization, but at the same time has recognized that success needs to take into account the rights of creditors as well as the debtor. In *NLRB v. Bildisco & Bildisco*, *supra*, this Court stated:

> Since the policy of Chapter 11 is to permit successful rehabilitation of debtors, rejection should not be permitted without a finding that

> that policy would be served by such action. The Bankruptcy Court must make a reasoned finding on the record why it has determined that rejection should be permitted. ***Determining what would constitute a successful rehabilitation involves balancing the interests of the affected parties – the debtor, creditors, and employees.*** The Bankruptcy Court must consider the likelihood and consequences of liquidation for the debtor absent rejection, the reduced value of the creditors' claims that would follow from affirmance and the hardship that would impose on them, and the impact of rejection on the employees. ***In striking the balance, the Bankruptcy Court must consider not only the degree of hardship faced by each party, but also any qualitative differences between the types of hardship each may face.***

465 U.S. at 527 (emphasis added). Thus, this Court has made pellucid that § 365 represents a convergence of multiple interests and goals. Nonetheless, the lower courts have struggled with the paucity of resources to understand the nature of such balancing as is embodied in § 365(b)(2)(D). The confluence of a profound need to implement congressional purpose and a lack of definitive authority to discern such purpose calls out for intervention by this Court.

Put another way, this is not one of those situations in which any answer, as long as it is clear and uniform, will do. To implement the delicate harmonization of intersecting concerns inherent in this section, the federal courts must arrive at an interpretation that meets all of the implicit purposes of the law. Only this Court can issue an opinion

that will instruct the courts as to the application of § 365(b) to carry out the legislative intent.

IV. Section 365 Affects Numerous Parties in Many Contexts Nationwide

There are substantial numbers of commercial entities who will be at risk of arbitrarily different outcomes. The number and type of executory contracts that are handled within the United States Bankruptcy Courts is large and varied. This problem, therefore, also has importance because it will affect a substantial number of entities throughout the United States. A few examples may suffice to demonstrate the ubiquity of the issue.

- Auto lessors will find the First Circuit's ruling troublesome. Such nonmonetary defaults as failure to maintain insurance, vehicle in the possession of a third party, and vehicle taken out of the jurisdiction are essential terms of the contract. In states where vicarious liability is applied to lessors, compliance with nonmonetary provisions is extremely important.

- In the franchise arena, it creates enormous difficulty to allow assumption of license agreements without a cure of the non-monetary provisions. In this context, licensors and franchisors value the nonmonetary provisions in some cases more than the monetary ones because they relate to the core value of their product.

- Almost every software license contains critical nonmonetary obligations to keep the software functional and updated. The failure of a debtor to do so robs the other party of much, sometimes all, of the value of their bargain.

- It is now common for contracts to contain detailed provisions regarding the handling of hazardous materials or wastes to avoid liability imposed on – and even criminal prosecution of – the contracting parties. Such obligations are inherently executory. To allow debtors to assume contracts without requiring compliance would create catastrophic results, particularly because the automatic stay would prevent prosecution of injunction actions without the permission of the very same bankruptcy court that would have just permitted assumption of the contract.

- Many construction and repair contracts contain detailed provisions relating to documentation of the work performed and setting forth safety standards. To permit a debtor to assume a contract without coming into compliance with such requirements would call into question the viability of the project itself.

- As noted above, various types of licenses and other financial arrangements contain scope or use limitations. At present, the enforceability of such provisions as a condition for assumption is now entirely dependent on the location of the bankruptcy.

Additional examples of the importance of this issue could be listed without difficulty. This is consistent with the First Circuit's own characterization of the issue as an "important question." As a result, the First Circuit's decision and the legal issue it embodies are more than sufficiently important to merit Supreme Court review.

V. The Exclusions in Section 365(b)(2) Are Incorporated Into a Number of Other Bankruptcy Code Provisions

Section 365(b)(2)(D) does not stand in isolation in the Bankruptcy Code. Thus, while it dictates what defaults must be cured in connection with an assumption of an executory contract or unexpired lease, its interpretation also determines what obligations must be complied with prior to assumption and whether the obligations need to be satisfied under a Chapter 11 plan of reorganization. Section 365(d)(3) provides that "[t]he trustee shall timely perform all the obligations of the debtor, ***except those specified in section 365(b)(2)***, arising from and after the order for relief under any unexpired lease of nonresidential real property, until such lease is assumed or rejected." 11 U.S.C. § 365(d)(3) (emphasis added). Similarly, § 365(d)(10) provides that

> [t]he trustee shall timely perform all of the obligations of the debtor, ***except those specified in section 365(b)(2)***, first arising from or after 60 days after the order for relief in a case under chapter 11 of this title under an expired lease of personal property . . . until such lease is assumed or rejected.

11 U.S.C. § 365(d)(3) (emphasis added). And, section 1124(2) treats a claim as unimpaired if, among other things, the Chapter 11 plan of reorganization "cures any . . . such default

that occurred before or after the commencement of the case under this title, ***other than a default of a kind specified in section 365(b)(2) of this title***." 11 U.S.C. § 1124(2)(A) (emphasis added).

Because of the dependence of other provisions of the Bankruptcy Code on the interpretation of § 365(b)(2)(D), the failure to address the conflict in the circuits not only will leave uncertain the rights and obligations of the trustee or debtor in possession on the one hand and the non-debtor contracting party on the other hand with regard to what obligations must be satisfied ***upon assumption***, but also, pursuant to §§ 365(d)(3) and 365(d)(10) what obligations must be satisfied pending assumption or rejection. Other questions flow from this as well. For example, does this mean that a trustee or debtor in possession can ignore all nonmonetary obligations in a lease prior to assumption notwithstanding the broad direction in §§ 365(d)(3) and 365(d)(10) to abide by the terms of the lease? In the Chapter 11 plan confirmation process, § 1124(2) makes it clear that how one interprets section 365(b)(2)(D) will affect the parties' rights long after the Chapter 11 plan is confirmed. Because unimpaired creditors are deemed to have voted for the plan of reorganization,[5] it is beyond question that Chapter 11 debtors will argue that they can force the counter-party to the contract to continue with the contract without cure or any compensation whatsoever. While the First Circuit's opinion seems to preserve the right to raise the claim separate and apart from the assumption proceeding, that decision, when read in conjunction with § 1126(2)(A), may actually preclude that right.

5. Section 1126(f) provides that "a class that is not impaired under a plan, and each holder of a claim or interest of such class, are conclusively presumed to have accepted the plan." 11 U.S.C. § 1126(f).

CONCLUSION

For the foregoing reasons, the Petitioners respectfully request that this Court grant review of this matter.

Respectfully submitted,

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APPENDIX

APPENDIX A — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT DATED MARCH 15, 2004

UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

No. 03-9006

IN RE BANKVEST CAPITAL CORP.,

Debtor.

EAGLE INSURANCE COMPANY and NEWARK INSURANCE COMPANY,

Appellants,

v.

BANKVEST CAPITAL CORP.,

Appellee.

APPEAL FROM THE UNITED STATES BANKRUPTCY APPELLATE PANEL FOR THE FIRST CIRCUIT

Before
Lynch, Circuit Judge,
Campbell, Senior Circuit Judge,
and Lipez, Circuit Judge.

March 15, 2004

Appendix A

LYNCH, *Circuit Judge.* This case presents a narrow but important question of statutory interpretation under the Bankruptcy Code: whether 11 U.S.C. § 365(b)(2)(D) permits the debtor-in-possession to assume an unexpired lease without first curing nonmonetary defaults. The Ninth Circuit, in the only court of appeals opinion to address this question, held that non-monetary defaults must be cured before assumption. *In re Claremont Acquisition Corp.*, 113 F.3d 1029, 1034-35 (9th Cir. 1997). In the proceedings below, the bankruptcy court and the Bankruptcy Appellate Panel (BAP) reached the opposite conclusion. We disagree with the Ninth Circuit and affirm.

I.

For purposes of this appeal, we accept the facts as alleged by appellants.[1] BankVest Capital Corporation, the debtor and appellee in this action, was in the business of originating, securitizing, selling, and servicing equipment leases. On May 27, 1999, appellants Eagle Insurance Company and Newark Insurance Company entered into separate but substantially similar lease agreements with BankVest.[2] BankVest agreed to lease 190 specified items of

1. This appeal arises from a special proceeding established under BankVest's confirmed Chapter 11 plan for the determination of cure costs under 11 U.S.C. § 365(b). The bankruptcy court treated the debtor's motion in opposition to appellants' claim for cure costs essentially as a motion to dismiss, accepting appellants' allegations of fact as true for purposes of the assumption analysis under § 365. Neither party has contested that sensible approach and we adopt it here.

2. The leases also named as a lessor LeaseVest Capital Corporation, a wholly owned subsidiary of BankVest. LeaseVest subsequently assigned its rights under the leases to BankVest.

computer equipment to each of the appellants for a term of 48 months. Under the leases, Eagle and Newark were obligated to make monthly rental payments of $10,111.82 and $11,940.61, respectively. BankVest agreed to arrange for delivery of the equipment directly from Nortel, the manufacturer.

Eagle and Newark were aware, however, that Nortel would not complete production of twenty of the 190 items until several months after the start of the lease term. Those twenty items, Eagle and Newark say, collectively accounted for 60% of the entire value of the leased goods and constituted the most critical pieces of equipment. Accordingly, it was agreed that Nortel would provide appellants with substitute "loaner" equipment until those twenty items were completed and delivered.[3] Nortel delivered the leased equipment, including the substitute items, in August 1999. On August 25, Eagle and Newark executed certificates of acceptance acknowledging their receipt of the leased equipment in operating condition.[4]

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3. BankVest denies that it was a party to the loaner arrangement and questions whether that arrangement actually occurred. BankVest says that Eagle and Newark unconditionally accepted all 190 items as delivered; that they never claimed the allegedly substitute equipment was defective or inferior; and that they in fact used those twenty items for two years without complaint.

4. Eagle and Newark argued to the bankruptcy court that they were forced to sign the certificates of acceptance before Nortel actually delivered the leased equipment, so they should not be estopped from asserting a defense of non-delivery if BankVest sues to recover unpaid rent. Like the bankruptcy court, we do not reach the estoppel question.

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On December 17, 1999, before the loaner equipment could be replaced, an involuntary Chapter 11 petition was filed against BankVest in the United States Bankruptcy Court for the District of Massachusetts. BankVest did not contest the petition, and the bankruptcy court entered an order for relief on January 25, 2000. Once in bankruptcy, BankVest proposed a plan of reorganization that contemplated a gradual liquidation of its assets. After several revisions, the bankruptcy court confirmed the plan on May 31, 2001. Meanwhile, Eagle and Newark continued to use the leased computer equipment but paid no rent to BankVest, accumulating a collective arrears of approximately $1 million. That debt remains unpaid.

This appeal arises out of the provisions in BankVest's confirmed Chapter 11 plan that govern the assumption of BankVest's unexpired equipment leases. The plan provides that every equipment lease in which BankVest is the lessor shall be deemed assumed by the estate under 11 U.S.C. § 365 unless (1) the lease is specifically rejected or (2) any party to the lease files a claim for cure costs. In the event a claim for cure costs is made, the plan permits BankVest to defer its decision whether to assume or reject the lease until the bankruptcy court determines the amount of the cure costs, if any, that the estate would be obligated to pay upon assumption.[5] *See* 11 U.S.C. § 365(b)(1).

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5. Specifically, paragraph 7.1 of the confirmed plan provides:

> All equipment leases, in which the Debtor is lessor, . . . shall be deemed assumed upon the Effective Date [of the plan] unless specifically rejected on or before such

(Cont'd)

Appendix A

On June 15, 2001, Newark and Eagle filed timely claims for cure costs under this procedure. They charged that BankVest had defaulted on the leases by failing to replace the loaner equipment with the final twenty items from Nortel.[6] Further, they contended that this non-monetary default was an historical fact not susceptible to cure (i.e., nothing BankVest could do would remedy its historical failure to deliver the equipment on time). In the alternative, Newark and Eagle argued that if the estate were allowed to cure, they would each be entitled to damages in excess of

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(Cont'd)

> date . . . , or unless a claim is made on or before the Effective Date that assumption hereunder requires the Debtor to pay Cure Costs to any party to an assumed contract or lease. In the event a claim for Cure Costs is made, the time for the Debtor to assume or reject any such contract or lease shall be extended until such time as the Bankruptcy Court enters a Final Order as to the Claimant's entitlement to Cure Costs and the amount of such Cure Costs, at which time the Debtor may determine whether to assume or reject such contract or lease.

The plan defines "Cure Costs" as "[t]hose payments and assurances required upon assumption of an executory contract or unexpired lease pursuant to 11 U.S.C. § 365(b)(1)."

6. Newark and Eagle also argued that BankVest's failure to deliver this equipment voided the leases entirely, so that there remained nothing to assume. The bankruptcy court did not address this issue, however, and appellants have not raised it on appeal. Accordingly, we will assume that appellants' leases are "executory contracts or unexpired leases" within the meaning of 11 U.S.C. § 365. *Cf. Gallivan v. Springfield Post Rd. Corp.*, 110 F.3d 848, 851 (1st Cir. 1997) (discussing the meaning of "executory").

$300,000, as well as reductions in the rent payments owed to BankVest. Finova Loan Administration, Inc., filed an objection to appellants' cure claims on behalf of the estate on August 15, 2001.[7]

Treating Finova's objection as a motion to dismiss, the bankruptcy court held a non-evidentiary hearing on November 7, 2001. On December 11, 2001, the court dismissed appellants' cure claims on a ground not raised by either party: that 11 U.S.C. § 365(b)(2)(D) permits the debtor-in-possession[8] to assume an executory contract or unexpired lease without first curing nonmonetary defaults. *In re BankVest Capital Corp.*, 270 B.R. 541, 543 -7- (Bankr. D. Mass. 2001). Because BankVest was not in default on any monetary provision – indeed, all of the payments under the leases flowed to BankVest, not from it – the court held

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7. On August 6, 2001, Finova and BankVest (in its capacity as debtor-in-possession) filed a stipulation with the bankruptcy court whereby Finova assumed BankVest's responsibility to defend appellants' cure claims. Since that time, Finova itself has filed for bankruptcy protection; U.S. Bank Portfolio Services has succeeded Finova on BankVest's behalf.

8. Section 365 speaks only of "the trustee," but in a Chapter 11 case, the debtor-in-possession enjoys all the rights and powers of the trustee. 11 U.S.C. § 1107(a). The debtor-in-possession is the "same entity which existed before the filing of the bankruptcy petition, but empowered by virtue of the Bankruptcy Code to deal with its contracts and property in a manner it could not have done absent the bankruptcy filing." *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 528 (1984) (internal quotation marks omitted). For brevity and convenience, this opinion refers to BankVest in its capacity as debtor-in-possession simply as "the debtor."

that there were no cure claims that had to be satisfied before assumption. *Id.* at 544. The BAP affirmed on the same ground. *In re BankVest Capital Corp.*, 290 B.R. 443, 447-48 (B.A.P. 1st Cir. 2003). Eagle and Newark timely appealed.

II.

This court has jurisdiction over appeals from the BAP under 28 U.S.C. § 158(d). We review the bankruptcy court's conclusions of law de novo, with the benefit of the BAP's bankruptcy expertise but without deference to its conclusions. Fed. R. Bankr. P. 7052; *In re Werthen*, 329 F.3d 269, 272 (1st Cir. 2003).

A. Legal Background

The dispute in this case concerns what is, in effect, an exception to an exception to the usual rule under 11 U.S.C. § 365. Section 365 generally allows the trustee in bankruptcy -- or, as in this case, the debtor-in-possession – to assume or reject any prepetition executory contract or unexpired lease, subject to the approval of the bankruptcy court. § 365(a); *In re FBI Distrib. Corp.*, 330 F.3d 36, 42 (1st Cir. 2003). This is one of the basic reorganizational tools available to debtors under the Bankruptcy Code. "[T]he authority to reject an executory contract is vital to the basic purpose [of] a Chapter 11 reorganization, because [it] can release the debtor's estate from burdensome obligations that can impede a successful reorganization." *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 528 (1984). Under the Code, a rejected contract is considered to have been in breach prior to the bankruptcy petition, leaving the nondebtor party to the contract with a

general unsecured claim for contract damages. 11 U.S.C. §§ 365(g)(1), 502(g); *FBI Distrib.*, 330 F.3d at 42. If the debtor assumes a contract, however, it accepts both the burdens and the benefits of the bargain, and any liabilities incurred in the contract's postpetition performance will be treated as administrative expenses with priority status. *See* 11 U.S.C. § 507(a)(1) (priority for administrative expenses); *FBI Distrib.*, 330 F.3d at 45. By permitting debtors to shed disadvantageous contracts but keep beneficial ones, § 365 advances one of the core purposes of the Bankruptcy Code: "to give worthy debtors a fresh start." *In re Carp*, 340 F.3d 15, 25 (1st Cir. 2003). There are, however, a variety of restrictions on the debtor's power to assume executory contracts and unexpired leases. Most relevant to this case is § 365(b), which provides that if the debtor has defaulted on a contract prior to assumption, the debtor cannot assume that contract unless it (1) cures the default; (2) compensates the nondebtor party for any actual pecuniary losses resulting from the default; and (3) provides adequate assurance of future performance under the contract.[9] § 365(b)(1). Like the bankruptcy court, we will assume *arguendo* that BankVest's failure to replace the loaner equipment constituted such a default. Yet the requirement in § 365(b)(1) that the debtor cure defaults prior to assumption itself has exceptions. Section § 365(b)(2) provides:

> (2) Paragraph (1) of this subsection does not apply to a default that is a breach of a provision relating to –

9. If cure and compensation are not feasible prior to assumption, the debtor may provide "adequate assurance" that it will do so promptly afterwards. 11 U.S.C. § 365(b)(1).

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. . .

> (D) the satisfaction of any penalty rate or provision relating to a default arising from any failure by the debtor to perform nonmonetary obligations under the executory contract or unexpired lease.

The bankruptcy court held, and the parties do not dispute, that BankVest's failure to deliver certain equipment is a "quintessential example of a nonmonetary default" within the meaning of subparagraph (2)(D). 270 B.R. at 544. The question on appeal is whether subparagraph (2)(D) excuses BankVest from the obligation that it otherwise bears under paragraph (1) to cure that default before assumption.

B. Interpretation of § 365(b)(2)(D)

(1) *Plain text*

As in any statutory interpretation case, we start with the text of the statute. *In re Hart*, 328 F.3d 45, 48 (1st Cir. 2003). The language of § 365(b)(2)(D) can plausibly be interpreted in at least two ways. Eagle and Newark argue that the word "penalty" in subparagraph (2)(D) describes both "rate" and "provision." On their reading, Congress intended that subparagraph to read like this:

> (D) the satisfaction of any penalty rate[, *or any penalty provision*] relating to a default arising from any failure by the debtor to

> perform nonmonetary obligations under the executory contract or unexpired lease.

This is essentially the interpretation that the Ninth Circuit endorsed in *In re Claremont Acquisition Corp., supra*, and a number of bankruptcy courts have since followed suit, *see, e.g., In re Williams*, 299 B.R. 684, 686 (Bankr. S.D. Ga. 2003); *In re New Breed Realty Enters.*, 278 B.R. 314, 320 (Bankr. E.D.N.Y. 2002); *In re Vitanza*, No. 98-19611DWS, 1998 WL 808629, at *21 n.44 (Bankr. E.D. Pa. Nov. 13, 1998).[10]

BankVest, on the other hand, argues that the word "penalty" describes only the term "rate," and that the second half of subparagraph (2)(D) creates a distinct exception for nonmonetary defaults. On this view, the statute is best interpreted like this:

> (D) the satisfaction of any penalty rate[, *or any*] provision relating to a default arising from any failure by the debtor to perform nonmonetary obligations under the executory contract or unexpired lease.

This is the interpretation favored by the bankruptcy court and the BAP below, as well as by the district court in the *Claremont* case. *See In re Claremont Acquisition Corp.*, 186 B.R. 977, 990 (C.D. Cal. 1995); *see also In re Walden Ridge Dev., LLC*, 292 B.R. 58, 67 & n.2 (Bankr. D.N.J. 2003); *In re W. Pac. Airlines, Inc.*, 219 B.R. 298, 304 (Bankr. D.

10. BankVest does not contend that its obligation to deliver the leased equipment was a "penalty provision."

Colo. 1998), *rev'd on other grounds*, 219 B.R. 305 (D. Colo. 1998); *In re GP Express Airlines, Inc.*, 200 B.R. 222, 233-34 (Bankr. D. Neb. 1996). If the plain language of the Bankruptcy Code required either of these interpretations, that would end the matter. *Lamie v. United States Trustee*, 124 S. Ct. 1023, 1030 (2004). But we see no textual basis for preferring appellants' interpretation to the one adopted by the bankruptcy court, which strikes us as equally consistent with the text. Nothing in the language or syntax of § 365(b)(2)(D) unambiguously requires either outcome. Indeed, we are hard-pressed to endorse any "plain meaning" argument where, as here, other federal courts have reached conflicting answers to the same question based on the same "plain" language. *Compare Claremont*, 113 F.3d at 1034, *and Williams*, 299 B.R. at 686, *with BankVest*, 290 B.R. at 447, *and Claremont*, 186 B.R. at 990. [11]

11. Eagle and Newark conspicuously have not urged this court to adopt the Ninth Circuit's textual analysis. In *Claremont*, the Ninth Circuit concluded that construing subparagraph (2)(D) to create a distinct exception for non-monetary defaults would be "grammatically incorrect and nonsensical" because the statute becomes grammatically incoherent if one simply deletes the words "satisfaction of any penalty rate." 113 F.3d at 1034. Even if that argument were properly before us, we would reject it. The text of § 365(b)(2)(D) is awkward and ungrammatical on any reading, including the reading that appellants urge; it proves nothing to say that the statute remains syntactically flawed when whole clauses are omitted. In any event, "the task of statutory interpretation involves more than the application of syntactic and semantic rules to isolated sentences." *Cablevision of Boston, Inc. v. Pub. Improvement Comm'n*, 184 F.3d 88, 101 (1st Cir. 1999). The wiser methodology, and the one that we employ here, is to interpret Congress's words in light of the goals and underlying policies of the statute as a whole. *Nieves-Marquez v. Puerto Rico*, 353 F.3d 108, 116 (1st Cir. 2003); *In re Weinstein*, 272 F.3d 39, 48 (1st Cir. 2001).

With a simple comma or two, Congress could have made its preferred interpretation clear. But the Code as written is ambiguous, so we must divine Congress's intent from other sources. *See In re Weinstein*, 272 F.3d 39, 48 (1st Cir. 2001) (where the Bankruptcy Code is ambiguous, courts look to "its historical context, its legislative history, and the underlying policies that animate its provisions"); *In re Christo*, 192 F.3d 36, 39 (1st Cir. 1999).

(2) *Legislative history*

The legislative history of § 365(b)(2)(D) is not instructive. Congress inserted subparagraph (D) as part of the Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, 108 Stat. 4106. Eagle and Newark place great weight on the single sentence in the legislative history of that Act that pertains to § 365(b)(2)(D):

> Finally, section 365(b) is clarified to provide that when sought by a debtor, a lease can be cured at a nondefault rate (i.e., it would not need to pay penalty rates).

H. Rep. No. 103-835 (parenthetical in original), *reprinted in* 1994 U.S.C.C.A.N. 3340, 3359. From this, appellants conclude that Congress must have intended subparagraph (2)(D) to address "penalty" provisions only. The *Claremont* decision likewise points to this legislative history as evidence "that Congress intended only to relieve debtors of the obligation to pay penalties." 113 F.3d at 1034.

We disagree. At best, the legislative history indicates that Congress intended § 365(b)(2)(D) to free debtors from lease provisions requiring the payment of penalty *rates* – something that both parties here agree that it does. [12] But subparagraph (2)(D) also refers to non-monetary defaults, and the legislative history does not indicate what Congress intended by that reference. To interpret the House Report's explanation of one clause of subparagraph (2)(D) as a limitation on the scope of a different, unmentioned clause would "overstate[] the inferences that can be drawn from an ambiguous act of legislative drafting." *Martin* v. *Hadix*, 527 U.S. 343, 357 (1999) (refusing to limit the scope of a statute by negative implication from the legislative history). Like the statutory text, the legislative history simply offers no guidance on the question that divides the parties.

Eagle and Newark also point to pending bankruptcy reform legislation that, they say, would codify their interpretation of subparagraph (b)(2). That is both untrue and unhelpful. For several years Congress has debated versions of the so-called Bankruptcy Abuse Prevention and Consumer Protection Act. None has yet passed. The most recent version of which we are aware, introduced in February 2003 by

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12. Even this much was not always clear, as the text of § 365(b)(2)(D) could be read, by negative implication, to require debtors to pay penalty rates arising from *monetary* defaults. *See In re Phoenix Bus. Park Ltd. P'ship*, 257 B.R. 517, 521 (Bankr. D. Ariz. 2001); Stein & Wheatly, *The Impact of Cure and Reinstatement on Default Interest*, 16 Am. Bankr. Inst. J. Jul./Aug. 1997, at 1. While that problem does not bear directly on the dispute in this case, it does tend to reinforce our conclusion that the text of subparagraph (2)(D) is ambiguous.

Representative Sensenbrenner, would strike the phrase "penalty rate or provision" in § 365(b)(2)(D) and replace it with "penalty rate or penalty provision." *See* H.R. 975, 108th Cong. § 328(a)(1)(B) (2003). But the same bill would also amend § 365(b)(1) to relax the cure requirement for certain nonmonetary defaults. *See id.* § 328(a)(1)(A). The most that can be gleaned from this unenacted legislation is that at least some members of Congress are aware that § 365(b)(2)(D) is a problem. It does not tell us how Congress in 1994 intended the present version of subparagraph (2)(D) to operate in cases like the one at bar.

(3) *Practical implications*

The best approach to interpreting § 365(b)(2)(D) focuses on practical considerations of bankruptcy policy and Congress's overarching purposes in the Bankruptcy Code. The *Claremont* decision has drawn sharp criticism from bankruptcy commentators, who nearly unanimously regard that case as an obstacle to the successful reorganization of many debtors in bankruptcy. *See, e.g.*, 3 Collier on Bankruptcy § 365.05[4] (15th ed. rev. 2003) (suggesting that *Claremont* reflects a "questionable" reading of subparagraph (2)(D) that is inconsistent with Congress's likely intent); Weintraub, *Historical Defaults and Cross-Defaults: Here a Default, There a Default, Everywhere a Default, Default, Default*, 26 Cal. Bankr. J. 286, 287 (2003) (*Claremont* imposes a "considerable roadblock" to the assumption and assignment of valuable contracts and "can have a potentially devastating effect" on the ability of certain debtors to reorganize); Stang, *Assumption of Contracts and Leases: The Obstacle of the Historical Default*, 24 Cal. Bankr. J. 39,

39 (1998) ("In restricting a debtor's ability to assume contracts and leases, the Claremont court undermined an important bankruptcy tool . . . in contravention of fundamental bankruptcy precepts."). The reasons for this criticism are evident. Many nonmonetary defaults are "historical facts" that are impossible to cure after the fact – for example, a debtor's failure to maintain leased property in a certain condition, to use leased equipment only for approved purposes, or to meet certain standards of quality or performance. [13] *See Vitanza,* 1998 WL 808629, at *24 n.51

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13. Of course, this depends on the definition of "cure," a term that is not defined in the Bankruptcy Code. Some courts and commentators have argued that some or even all non-monetary defaults are curable under the Code, whether or not they are "historical facts." *See, e.g., In re Walden Ridge Dev. Corp.*, 292 B.R. 58, 66-67 (Bankr. D.N.J. 2003); *In re Garcia*, 276 B.R. 627, 639-40 (Bankr. D. Ariz. 2002); Stang, *Assumption of Contracts and Leases: The Obstacle of the Historical Default*, 24 Cal. Bankr. J. 39 (1998). The prevailing view, however, is that many non-monetary defaults — especially those deemed "material" to the contract — cannot meaningfully be cured in bankruptcy. *See, e.g., Claremont*, 113 F.3d at 1034-35 (holding assumption barred because the debtors' default was an historical fact that could not be cured); *In re Beckett*, No. CIV.A. 00-5337, 2001 WL 767601, at *5-*6 (E.D. Pa. Jul. 5, 2001) (similar); *In re GP Express Airlines, Inc.*, 200 B.R. 222, 233 (Bankr. D. Neb. 1996) (airline's failure to maintain contractual performance obligations was an historical, non-monetary default and impossible to cure); *In re Lee West Enters.*, 179 B.R. 204, 208 (Bankr. C.D. Cal. 1995) (franchisee's closure for three months prior to bankruptcy petition was a non-monetary default that could not be cured); cf. 3 Collier on Bankruptcy § 365.05[4] (15th ed. rev. 2003) (referring to situations "where the trustee cannot go back in time to undo an act or omission of the debtor").

(most non-monetary defaults involve unalterable historical facts). Requiring a debtor to cure such incurable defaults is tantamount to barring the debtor from assuming any lease or contract in which such a default has occurred – no matter how essential that contract might be to the debtor's reorganization in bankruptcy. Indeed, that is exactly what happened in several cases following the *Claremont* rule. For example, in *In re Williams, supra*, the debtor was a professional truck driver who defaulted on his truck lease, which provided that he could only use his truck in the service of his employer. 299 B.R. at 684-85. The bankruptcy court ruled that the debtor's violation of that provision was an incurable historical default, then (citing *Claremont*) barred assumption of the lease under § 365, lifted the automatic stay, and allowed repossession of the debtor's truck. *See id.* at 686-87; *see also In re Beckett*, No. CIV.A. 00-5337, 2001 WL 767601, at *1, *5- *6 (E.D. Pa. Jul. 5, 2001) (permitting the debtor's eviction because the debtor could not cure her historical default on a lease provision requiring her to maintain her apartment in a "clean, orderly, and safe condition").

This cannot, in our view, be what Congress intended. To prevent a debtor from assuming a contract based on historical events that it cannot remedy undermines Congress's basic purpose in § 365: to promote "the successful rehabilitation of the business for the benefit of both the debtor and all its creditors."[14] *FBI Distrib.*, 330 F.3d at 45.

14. Eagle and Newark argue that § 365(b)(1) reflects a different policy goal: to ensure that the nondebtor party to an executory contract receives the benefit of its bargain if it is forced to continue (Cont'd)

This case well illustrates the force of that concern. Eagle and Newark together owe BankVest approximately $1 million in unpaid rent. Yet they argued to the bankruptcy court that BankVest's failure to complete delivery of the leased equipment is an "historical fact" not susceptible to cure. 270 B.R. at 541. So rather than simply seek an offset for any pecuniary harm they may have suffered, Eagle and Newark would deny the estate all $1 million in unpaid rent by compelling BankVest to cure what they allege is incurable.[15] That is plainly inconsistent with Congress's purpose in the Bankruptcy Code to maximize the value of the estate for all creditors. *Toibb* v. *Radloff*, 501 U.S. 157, 163 (1991); *In re Summit Corp.*, 891 F.2d 1, 5 (1st Cir. 1989);

(Cont'd)
performance after the debtor has filed for bankruptcy. See *In re Superior Toy & Mfg. Co.*, 78 F.3d 1169, 1174 (7th Cir. 1996). That policy concern is a legitimate one, but it does not control here. Bankruptcy by design involves the re-ordering of debtor-creditor relationships and the adjustment of bargains negotiated under more optimistic circumstances. Neither § 365(b)(1) nor any policy reflected therein alters the broader objective of the Bankruptcy Code to "give worthy debtors a fresh start." *In re Carp*, 340 F.3d 15, 25 (1st Cir. 2003); *cf. Bildisco*, 465 U.S. at 527 (bankruptcy courts "must focus on the ultimate goal of Chapter 11 when considering the[] equities" under § 365). Nor is the nondebtor party to a contract that is assumed notwithstanding a non-monetary default necessarily denied the benefit of its bargain, as it is free to sue the debtor for breach of contract after assumption.

15. We do not hold that BankVest's failure to deliver the last twenty items of leased equipment was in fact an incurable default, or even that it was a default at all. We merely accept that allegation for purposes of this appeal. The parties are free to litigate the facts of the appellants' allegations on remand (and after assumption).

see also United States v. *Shadduck*, 112 F.3d 523, 531 (1st Cir. 1997) (all creditors are injured by the efforts of a single creditor to keep property out of the estate).

All of this suggests that Congress meant § 365(b)(2)(D) to excuse debtors from the obligation to cure non-monetary defaults as a condition of assumption. The text, as we have said, readily bears that interpretation. It is not inconsistent with the meager legislative history. And developments in the bankruptcy courts prior to the 1994 amendments put Congress on notice of the problem of irremediable non-monetary defaults. *See, e.g.*, *In re Toyota of Yonkers, Inc.*, 135 B.R. 471, 477 (Bankr. S.D.N.Y. 1992) (failure to operate car dealership for seven consecutive days would constitute incurable historical default); *In re Deppe*, 110 B.R. 898, 904 (Bankr. D. Minn. 1990) (debtor's failure to maintain constant operations at gas station constituted incurable historical default); *In re Anne Cara Oil Co., Inc.*, 32 B.R. 643, 648 (Bankr. D. Mass. 1983) (gas station lessee's commingling of gasoline products was likely an incurable non-monetary default that would bar assumption).

This interpretation is also consistent with the remaining subparagraphs in § 365(b)(2), which are directed to so-called *ipso facto* clauses (for instance, contract provisions that force debtors into default merely for becoming insolvent or seeking bankruptcy protection). *See* § 365(b)(2)(A)-(C). Like defaults based on breaches of ipso facto clauses, non-monetary defaults are often a product of the debtor's very financial distress. In *Claremont* itself, for example, the non-monetary default that prevented the debtors from assuming their franchise agreement was their decision to close their

automobile dealership for the two weeks immediately prior to their bankruptcy petition. *Id.* So in the end, they were denied a valuable asset in their Chapter 11 reorganization because the same financial hardship that drove them into bankruptcy also forced them to default on their dealership agreement. This, we conclude, is among the *ipso facto* harms that Congress intended § 365(b)(2)(D) to prevent.[16] *Cf.* Weintraub, *supra*, at 292 n.20 (noting the similar interests served in § 365(b)(2)(D) by barring the enforcement of penalty rates and by preventing historical nonmonetary defaults from automatically precluding assumption).

Eagle and Newark assert that subparagraph (2)(D) cannot apply to all non-monetary defaults because that interpretation would render the *ipso facto* default provisions superfluous. *See Claremont*, 113 F.3d at 1034 (endorsing this argument). We disagree. The *ipso facto* defaults described in subparagraphs (A)-(C) are not *necessarily* non-monetary. For example, a breach of a provision relating to "the financial condition of the debtor" might well be monetary in nature, depending on the underlying contract. Subparagraph (2)(D) is not so "wholly superfluous" as to preclude what we

16. Non-monetary contractual obligations are similar to the *ipso facto* provisions in § 365(b)(2)(A)-(C) in another respect: the likelihood of default is under the control of the parties. This creates the risk that a potential creditor can effectively "bankruptcy-proof" its contract with a financially troubled company by making the deal contingent on the achievement of stringent performance or quality benchmarks. One recognized purpose of the *ipso facto* clauses in § 365(b)(2) is to prevent creditors from opting out of the bankruptcy process in this manner. *See generally* Collier on Bankruptcy, *supra*, at § 365.05[4].

consider to be its most sensible interpretation. *Conn. Nat'l Bank* v. *Germain*, 503 U.S. 249, 253 (1992). There may be substantial overlap among the provisions of § 365(b)(2), but redundancy is not the same as surplusage. *See Germain*, 503 U.S. at 253 ("Redundancies across statutes are not unusual events in drafting, and so long as there is no positive repugnancy between two laws . . . a court must give effect to both." (internal citation and quotation marks omitted)).

C. Application of § 365(b)(2)(D)

We hold that under § 365(b)(2)(D), BankVest need not cure non-monetary defaults before assuming its equipment leases with Eagle and Newark. This clears the way for BankVest to assume the leases (subject to the approval of the bankruptcy court) and to file an action to collect the $1 million in outstanding rent. And in that action, Eagle and Newark may raise their defenses to payment and may counterclaim for damages for any losses actually suffered through BankVest's alleged breach. "[I]t seems that Congress's intent in enacting [§ 365(b)(2)(D)] was to address just such a situation, that is, where the trustee cannot go back in time to undo an act or omission of the debtor but could compensate for any actual pecuniary loss that the other contracting party suffered as a result of the default." Collier on Bankruptcy, *supra*, § 365.05[4] (criticizing *Claremont*). We emphasize, however, that the assumption proceeding itself is not the place to resolve those issues. *See In re Orion Pictures Corp.*, 4 F.3d 1095, 1098-99 (2d Cir. 1993) ("At heart, a motion to assume should be considered a summary proceeding, intended to efficiently review the trustee's or debtor's decision to adhere to or reject a particular

contract in the course of the swift administration of the bankruptcy estate. It is not the time or place for prolonged discovery or a lengthy trial with disputed issues."); *In re Docktor Pet Ctr., Inc.*, 144 B.R. 14, 16 (Bankr. D. Mass. 1992). As the BAP concluded, "[i]f a debtor wants to assume [a contract] in its business judgment, knowing that issues other than payment due may be litigated after assumption, the debtor should be allowed to do so." 290 B.R. at 448.

III.

The judgment of the Bankruptcy Appellate Panel is ***affirmed***.

APPENDIX B — OPINION OF THE UNITED STATES BANKRUPTCY APPELLATE PANEL FOR THE FIRST CIRCUIT DATED MARCH 28, 2003

UNITED STATES BANKRUPTCY APPELLATE PANEL FOR THE FIRST CIRCUIT

BAP Nos. MW 01-089 and MW 01-090
(consolidated appeals)

BANKVEST CAPITAL CORP.,

Debtor

EAGLE INSURANCE COMPANY
and
NEWARL INSURANCE COMPANY,

Plaintiffs-Appellants

v.

BANKVEST CAPITAL CORP.,

Defendant-Appellee.

Appeal from the United States Bankruptcy Court
for the District of Massachusetts
(Hon. Joel B. Rosenthal, U.S. Bankruptcy Judge)

Before VAUGHN, BROWN and KORNREICH,
U.S. Bankruptcy Appellate Judges

March 28, 2003

Appendix B

VAUGHN, U.S. Bankruptcy Appellate Panel Judge.

Eagle Insurance Company ("Eagle") and Newark Insurance Company ("Newark") (collectively "Appellants") appeal from the Decision and Order ("Decision") of the United States Bankruptcy Court for the District of Massachusetts ("Bankruptcy Court") entered on December 12, 2001. *See In re BankVest Capital Corp.*. 270 B.R. 541 (Bankr. D. Mass. 2001). The Decision denied the Appellants' request for the payment of cure costs pursuant to § 365 of the United States Bankruptcy Code (the "Code") and BankVest Capital Corporation's ("Debtor's" or "Appellee's") confirmed plan of reorganization. [1] For the reasons set forth below, the Decision of the Bankruptcy Court is affirmed.

BACKGROUND

The Appellants entered into separate Master Equipment Lease Agreements (collectively, "Lease Agreements") with LeaseVest Capital Corp. ("LeaseVest") and the Debtor on May 27, 1999. Pursuant to the Lease Agreements, Eagle and Newark were to lease approximately 190 pieces of computer equipment from LeaseVest and the Debtor for monthly rental payments of $11,940.61 and $10,111.82, respectively. However, the Appellants only received some of the equipment, plus 20 pieces of "loaner equipment" from LeaseVest and the Debtor's vendor, Nortel.

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1. Unless otherwise noted, all statutory section references herein are to the Bankruptcy Reform Act of 1978, as amended, 11 U.S.C. §§ 101, *et seq*.

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The Debtor was placed into an involuntary bankruptcy on December 17, 1999, before the loaner equipment was replaced. The Debtor's reorganization plan indicated that all parties which required cure costs pursuant to § 365 file such requests before the effective date of the order confirming the plan.[2] The Appellants filed their claims for payment of cure costs on June 15, 2001, asserting that the Debtor's breach could not be cured. To the extent the breach could be cured, the Appellants sought damages.[3] App. at 111, 133. Finova

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2. Specifically, Paragraph 7.1 of the Plan and Confirmation Order provides:

> All equipment leases, in which the Debtor is lessor, which are part of the Owned Portfolio, the Warehouse Portfolio and such other leases as the holders of Allowed Secured Claims timely request be assumed and assigned, shall be deemed assumed upon the Effective Date unless specifically rejected on or before such date or a motion to reject regarding a particular lease is pending, or unless a claim is made on or before the Effective Date that assumption hereunder requires the Debtor pay Cure Costs to any party to an assumed contract or lease.

App. at 55.

3. Eagle alleged total damages of $330,542.64, while Newark calculated its damages at $314,372.64. Both Appellants alleged that damages included actual damages of $88,145 consisting of additional payroll expenses ($71,075); outsourced labor ($12,000); outsourced training ($2,000); and additional repair costs ($3,070). App. at 132, 152. In addition, both sought an unspecified reduction of the lease payments for the period during which they did not have the non-delivered items. App. at 111, 133.

Loan Administration, Inc. ("Finova") filed an objection to the claims on August 15,2001 on behalf of the Debtor.[4] App at 153-72.

The Bankruptcy Court held a non-evidentiary hearing[5] on November 7,2001 and entered its Decision on December 12,2001, sustaining Finova's objection to Appellants' claims and holding that to assume the pre-petition Lease Agreements, the Debtor had to cure only its monetary defaults, if any, and did not have to cure non-monetary defaults arising from the delivery of substituted equipment to the Appellants. App. 236-37. On December 21,2001, the Appellants filed their notices of appeal. App. at 238-41.

JURISDICTION

Pursuant to 28 U.S.C. §§ 158(a), the Panel may hear appeals "from final judgments, orders, and decrees." 28 U.S.C. § 158(a)(l). A final judgment "ends the litigation on the merits and leaves nothing for the court to do but execute the judgment." *Catlin v. United States*, 324 U.S. 229,233 (1945). The instant appeal arises from a final order of the Bankruptcy Court denying the Appellants' request for cure costs pursuant to § 365 of the Code.

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4. Finova and the Debtor entered into a stipulation, filed with the Bankruptcy Court on August 6, 2001, whereby Finova agreed to assume the Debtor's responsibility to defend the cure claims asserted by Eagle and Newark.

5. The Bankruptcy Court essentially treated the issues before it as a motion to dismiss, considering the Appellants' well pleaded allegations of fact to be true for purposes of its analysis of §365.

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STANDARD OF REVIEW

Generally, the Panel evaluates the Bankruptcy Court's findings of fact pursuant to the "clearly erroneous" standard of review and its conclusions of law *de novo. Grella v. Salem Five Cent Savings Bank*, 42 F.3d 26, 30 (1st Cir. 1994); *see also Palmacci* v. *Umpierrez.* 121 F.3d 781, 785 (1st Cir. 1997). Following a non-evidentiary hearing, the Bankruptcy Court rendered its Decision based upon its interpretation of § 365(b)(2)(D). Therefore, the only question presented on appeal is one of law and we review the Bankruptcy Court's conclusions *de novo. See Jeffrey v. Desmond.* 70 F.3d 183, 185 (1st Cir. 1995);. *In re SPM Mfg. Corp.*, 984 F.2d 1305,1311 (1st Cir. 1993); *In re Indian Motocycle Co.. Inc.*, 261 B.R. 800, 805 (B.A.P. 1st Cir. 2001).

DISCUSSION

The Bankruptcy Court held that:

> Common sense dictates that the failure to deliver certain items is a quintessential example of a nonmonetary default. The Debtor was not required to make any payments. Indeed the money was to flow from Eagle and Newark to the Debtor. Therefore there are no cure claims to be satisfied before assumption and assignment of the leases. At best there are only claims for whatever damages Eagle and Newark can demonstrate flowed from the delivery of loaner items in place of the scheduled items. These claims need to be addressed in the context of an evidentiary hearing

> at which the parties will have to introduce evidence as to the claims and defenses thereto[.]

270 B.R. at 544; App. at 236-37. Thus, the central issues presented in this appeal are whether the Bankruptcy Court erred in (1) interpreting § 365(b)(2)(D) as not requiring the Debtor to cure any non-monetary defaults as a condition to assuming the Lease Agreements executed by the Appellants, and (2) finding that any claims or defenses available to the Appellants based on the Debtor's alleged non-monetary default should be addressed in the context of an evidentiary hearing in a court of competent jurisdiction. The Panel finds that the Bankruptcy Court did not err in either of its determinations.

Section 365(b) provides in relevant part:

> (1) If there has been a default in an executory contract or unexpired lease of the debtor, the trustee may not assume such contract or lease unless, at the time of assumption of such contract or lease, the trustee—
>
> > (A) cures, or provides adequate assurance that the trustee will promptly cure, such default;
> >
> > (B compensates, or provides adequate assurance that the trustee will promptly compensate, a party other than the debtor to such contract or lease, for any actual pecuniary loss to such party resulting from such default; and

> (C) provides adequate assurance of future performance under such contract or lease.
>
> (2) Paragraph (1) of this subsection does not apply to a default that is a breach of a provision relating to —
>
> > (D) the satisfaction of any penalty rate or provision relating to a default arising from any failure by the debtor to perform nonmonetary obligations under the executory contract or unexpired lease.

11 U.S.C. § 365(b). Cure Costs are defined under the plan as "[t]hose payments and assurances required upon assumption of an executory contract or unexpired lease pursuant to 11 U.S.C. section 365(b)(l)." App. at 22.

Applying *In the Matter of GP Express Airlines. Inc.* and *In re Western Pacific Airlines, Inc.*, the Bankruptcy Court found that the plain language of § 365(b)(2)(D) supported the "interpretation that penalty rate obligation and a non-monetary default are two separate types of breaches which a debtor is not required to cure prior to assumption of a contract." *BankVest*, 270 B.R. at 543; App. at 236: *see also GP Express Airlines*, 200 B.R. 222, 233-34 (Bankr. D. Neb. 1996) (determining that § 365(b)(2)(D) addresses "two separate issues . . . . [A] debtor is not required to cure or satisfy any penalty rate obligation and the debtor is not required to cure any defaults in nonmonetary obligations.

The statutory term 'rate' refers to interest rate. . . . By definition, there is no interest accrual on a nonmonetary obligation."); *Western Pacific Airlines*, 219 B.R. 298, 304 (Bankr. D. Colo. 1998), *rev'd on other grounds,* 219 B.R. 305 (D. Colo. 1998).

The Appellants argue that the Bankruptcy Court misinterpreted § 365(b)(2)(D), alleging that a majority of courts read the section as excusing a Debtor from curing a penalty rate or provision relating to a non-monetary default, but not the non-monetary default itself. Accordingly, they urge the adoption of *Claremont Acquisition Corp. v. General Motors Corp. (In re Claremont Acquisition Corp.)* which holds that the word "penalty" modifies both "rate" and "provision" and. therefore, a debtor's failure to operate for seven consecutive days is not a non-monetary default that can be excused under § 365(b)(2)(D). 113 F.3d 1029 (9th Cir. 1997). The Bankruptcy Court had rejected the Ninth Circuit's interpretation of § 365(b)(2)(D), noting that both the bankruptcy and district courts in *Claremont* had interpreted § 365 as not requiring cure of debtor's past non-monetary default. 270 B.R. at 543; App. at 236.

The cases cited by the Appellants do not support their contention that a majority of courts support the *Claremont* reading of § 365. The Fourth Circuit decision cited, *Three Sisters Partners, LLC v. Harden (In re Shangra-La. Inc.)*, only addresses § 365(b)(2)(D) in dicta, noting that default rate interest penalty is not available for non-monetary default rates. *Shangra-La*, 167 F.3d 843, 848 n.3 (4th Cir. 1999). Similarly, the language cited from *In re Ernst Home Center. Inc.* by the Appellants is also dicta located in a

footnote. 209 B.R. 955, 963 n.6 (Bankr. W.D. Wash. 1997). In *Ernst*, no motion to assume had been filed. *See id.* at 958-60. The unreported decision of *In re Vitanza* is also not on point. *Vitanza*. No. 98-19611,1998 Bankr. LEXIS 1497 (Bankr. E.D. Pa. Nov. 13, 1998). In that case, the necessity of curing a non-monetary default was not a component of the court's holding, but the court addressed § 365(b)(2)(D) by noting that it "only relieves debtors of their obligation to pay penalties and not of their obligation to cure non-monetary defaults." *Id.* at *75 n.44. The court in *Vitanza* also stated, in dicta, that:

> Most non-monetary defaults (e.g., failure to maintain the premises in a certain condition, failure to seek approval; failure to provide reasonable consent) are "historical facts." Consequently, if [the lessor's] "historical fact" theory were applied to all non-monetary defaults, it would, in effect, eliminate the right to assume a lease for which non- monetary defaults exist. If Congress had intended to limit the right to assume to leases involving only monetary defaults, it could have so stated in § 365.

Id. at *87 n.51.

This Panel affirms the Bankruptcy Court's plain language interpretation of § 365(b)(2)(D). In practice, if debtors had to cure non-monetary defaults, many leases could not be assumed because the cure would be impossible to accomplish. By extension, the Panel adopts the *GP Express Airlines* interpretation of § 365(b)(2)(D). However, the Panel does

not adopt its holding that a separate trial needs to be held not only as to the non-monetary defaults under contracts, but also as to the issue of whether the debtor can give adequate assurance of future performance under executory contracts.

Based on the language of the Debtor's Plan and Confirmation Order that "[all equipment leases, in which the Debtor is lessor, . . . shall be deemed assumed upon the Effective Date unless specifically rejected on or before such date or a motion to reject regarding a particular lease is pending, or unless a claim is made on or before the Effective Date that assumption hereunder requires the Debtor to pay Cure Costs to any party to an assumed contract or lease[,]" the present case involves assumption only. App. at 55. In order to assume, a debtor does not have to cure non-monetary defaults. However, to assign under § 365(f)(2)(B), a debtor must show an adequate assurance of future performance. This additional requirement provides protection from non-monetary defaults when a third party is involved in the transaction. If there is just an assumption, the parties can still litigate their issues of breach as if there was no bankruptcy.

Under a motion to assume or reject an executory contract the only issue properly before a court is whether the assumption or rejection of the subject contract is based upon a debtor's business judgment. *See Orion Pictures Corp. v. Showtime Networks. Inc.*, 4 F.3d 1095, 1099 (2d Cir. 1993), *cert. dismissed.* 511 U.S. 1026 (1994); *In re Docktor Pet Center. Inc.*, 144 B.R. 14, 16 (Bankr D. Mass- 1992) In *Orion* the Second Circuit reversed both the-bankruptcy and district

courts and held that, in ruling on the debtor's motion to assume a contract, the bankruptcy court should not have resolved the disputed issue regarding the debtor's alleged breach of the agreement. The *Orion* court stated that:

> The bankruptcy court erred because it misapprehended the fundamental nature and purpose of a motion to assume. At heart, a motion to assume should be considered a summary proceeding, intended to efficiently review the trustee's or debtor's decision to adhere to or reject a particular contract in the course of the swift administration of the bankruptcy estate.

4 F.3d at 1098. Further, in *Docktor Pet Center*, the Bankruptcy Court for the District of Massachusetts held that "a motion to assume an executory contract is generally, and should be, a summary proceeding." 144 B.R. at 16. Accordingly, the Bankruptcy Court's determination that the "parties are free to pursue whatever claims, counterclaims, and defenses they have in a non-bankruptcy court of competent jurisdiction" is consistent with the holdings of *Orion* and *Docktor Pet Center*. 270 B.R. at 544; App. at 237.

In the instant appeal, there was no issue relative to the Debtor's business judgment regarding the assumption of the Lease Agreements. Although no factual findings were made, it is undisputed that the Appellants were not entitled to any contractual payment under the terms of the Lease Agreements. If a debtor wants to assume in its business judgment, knowing that issues other than payment due may be litigated after assumption, the debtor should be allowed to do so.

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CONCLUSION

For the reasons set forth above, the Panel finds the Bankruptcy Court .did not err in interpreting § 365(b)(2)(D) as not requiring the Debtor to cure any non-monetary defaults as a condition to assuming the Lease Agreements executed by the Appellants and finding that any claims or defenses available to the Appellants based on the Debtor's alleged non-monetary default should be addressed in the context of an evidentiary hearing in a court of competent jurisdiction. Accordingly, the Bankruptcy Court's Decision is AFFIRMED.

APPENDIX C — DECISION AND ORDER OF THE UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF MASSACHUSETTS DATED DECEMBER 11, 2001

UNITED STATES BANKRUPTCY COURT
DISTRICT OF MASSACHUSETTS

Chapter 11
Case No. 99-47760-JBR

In re:

BANKVEST CAPITAL CORPORATION,

DEBTOR

DECISION AND ORDER
ON REQUESTS FOR PAYMENT OF CURE COSTS
[#850 AND #851]

This matter having come before the Court for hearing on the Request of Newark Insurance Company for Payment of Cure Costs [#850], the Objection by Finova Loan Administration, Inc. to Statement of Cure of Newark Insurance Company[#947] the Request of Eagle Insurance Company for Payment of Cure Costs [#851], Inc., and the Objection by Finova Loan Administration, Inc. to Statement of Cure of Eagle Insurance Company [#948], and after consideration of the foregoing, the memoranda of law filed by the parties, and the arguments of counsel, the Court makes the following findings and conclusions.

Appendix C

The Cure Claims

Newark Insurance Company ("Newark") and Eagle Insurance Company ("Eagle", collectively with Newark, the "Claimants") filed separate but substantially similar requests for the payment of cure costs on June 15, 2001. The requests were timely as Eagle and Newark had sought and obtained clarification of the deadline for filing such claims. Newark and Eagle allege that the Debtor failed to deliver all of the leased equipment. Specifically they state that the Debtor did not deliver 20 of the 190 items it was to deliver to each Claimant. Instead "substitute loaner" items were delivered in place of those 20 items.

The Claimants allege that the breach is such that it cannot be cured. To the extent that it can be cured however, each claims damages as a result of the delivery of the loaner items and the failure to deliver the 20 items enumerated in Schedule A to the leases. Eagle alleges total damages of $330,542.64 while Newark calculates its damages at $314,372.64. Both Claimants allege that the damages include actual damages of $88,145 consisting of additional payroll charges ($71,075); outsourced labor ($12,000); outsourced training ($2,000); and additional repair costs($3,070). In addition both seek an unspecified reduction of the lease payments for the period during which they did not have the non-delivered items.

During the bankruptcy, Finova Loan Administration, Inc. ("Finova") was authorized to administer certain commercial leases including those at issue herein and it continues in that capacity. Pursuant to the Debtor's Fifth Amended Joint

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Liquidating Plan of Reorganization, as modified (the "Plan"), which was confirmed by the Court, the Debtor proposed to assume and assign certain leases, including the ones at issue, although it also reserved the right to defer a final decision to reject or assume and assign, in the event a cure claim was filed, until after adjudication of the cure claim. Finova filed objections to each cure claim asking that each claim be denied in its entirety.

Background

On or about May 27, 1999 Eagle and Newark entered into separate but substantially similar Master Equipment Lease Agreements (the "Lease Agreements") with LandVest Capital Corp. ("LandVest") and BankVest Capital Corp. (the "Debtor") whereby LandVest and the Debtor were to lease certain computer equipment to the Claimants. On or about June 29, 1999 LandVest and each of the Claimants entered into Lease Schedules that were incorporated into the master Lease Agreements. Pursuant to Lease Schedule No. 001 Eagle agreed to make 48 monthly payments of $11,940.61 per month for the rental of the equipment set forth in Schedule A to Lease Schedule No. 001. Pursuant to Lease Schedule No. 002 Newark agreed to make 48 monthly payments of $10,111.82 per month for the equipment set forth in the Schedule A attached to Lease Schedule No. 002. Both Lease Schedules No. 001 and No. 002 provided that "[t]he rental payments may change for Equipment accepted after Aug. 31, 1999." "Equipment" is defined in each of the Lease Schedules as the equipment set forth in the respective Schedules A.

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LandVest or the Debtor were to obtain the leased equipment from Nortel. At the time the parties entered into the Lease Agreements, they knew that Nortel would not complete production of approximately 20 of the leased items until several months after the commencement of the lease term. Therefore the parties agreed that Nortel would provide loaner equipment in place of the not yet manufactured items.

In or about August 1999 the items were delivered with the loaner equipment delivered in place of the not yet manufactured items. On August 25, 1999 both Eagle and Newark executed Certificates of Acceptance (the "Certificates") that were signed by Philbert Nezamodeen who was the Vice President and Chief Operating Officer of Eagle and the Vice President and Treasurer of Newark. In addition Mr. Nezamodeen was also the secretary of Material Damage Adjustment Corp. which shares the same address as Eagle and Newark and which guaranteed the obligations of Eagle and Newark under their respective leases. Eagle also guaranteed Newark's obligations while Newark guaranteed Eagle's. At the hearing, Eagle and Newark's counsel argued that the claimants were forced to deliver the Certificates before the Debtor would deliver the equipment and therefore argued that the Claimants should not be estopped from asserting the nondelivery of the 20 items which they characterize as a "substantial" portion of the leased equipment. The Court need not reach and decide the estoppel issue.

Appendix C

Is the debtor required to cure these defaults in order to assume the leases?

11 U.S.C.A. § 365(b) provides in relevant part:

(1) If there has been a default in an executory contract or unexpired lease of the debtor, the trustee may not assume such contract or lease unless, at the time of assumption of such contract or lease, the trustee–

> (A) cures, or provides adequate assurance that the trustee will promptly cure, such default;
>
> (B) compensates, or provides adequate assurance that the trustee will promptly compensate, a party other than the debtor to such contract or lease, for any actual pecuniary loss to such party resulting from such default; and
>
> (C) provides adequate assurance of future performance under such contract or lease.

(2) Paragraph (1) of this subsection does not apply to a default that is a breach of a provision relating to–

> (D) the satisfaction of any penalty rate or provision relating to a default arising

> from any failure by the debtor to perform nonmonetary obligations under the executory contract or unexpired lease.

Although none of the parties have raised the issue, Section 365(b)(2)(D) may govern this matter. There is disagreement among the courts that have interpreted this section as to whether the word "penalty" defines both the word "rate" and the phrase "provision relating to a default arising from any failure of the debtor to perform nonmonetary obligations." In other words, must the nonmonetary default arise from a penalty provision?

In *In the Matter of GP Express Airlines, Inc.*, 200 B.R. 222 (Bankr. D. Neb. 1997), the court read Section 365(b)(2)(D) "as addressing two separate issues. . . . [A] debtor is not required to cure or satisfy any penalty rate obligation and the debtor is not required to cure any defaults in nonmonetary obligations. The statutory term 'rate' refers to interest rate. . . . By definition, there is no interest accrual on a nonmonetary obligation." *Id.* at 233-34. The court did note, however, that excusing the debtor from curing pre-assumption nonmonetary defaults did not relieve it from the requirement under Section 365(b)(l)(C) of demonstrating that all obligations, including nonmonetary ones, could be met post-assumption. *Accord In re Western Pacific Airlines, Inc.*, 219 B.R. 298, 304 (Bankr. D. Colo. 1998). *But see Claremont Acquisition Corp.* v .*General Motors Corp. (In re Claremont Acquisition Corp.)*, 113 F.3d 1029 (9th Cir. 1997) (holding that the word "penalty" modifies both "rate" and "provision" and therefore debtor's failure to operate for

7 consecutive days is not a nonmonetary default that can be excused under section 365(b)(2)(D)), *aff'g on other grounds*, 186 B.R. 977 (C.D.Cal. 1995) (both district court and bankruptcy court interpreted Section 365(b)(2)(D) as not requiring cure of debtor's past nonmonetary default arising from failure to operate).

The plain language of Section 365(b)(2)(D) supports the *GP Express Airlines* interpretation that penalty rate obligation and a nonmonetary default are two separate types of breaches which a debtor is not required to cure prior to assumption of a contract. Therefore whether BankVest could even cure the past defaults is irrelevant if the failure to deliver the 20 items is a nonmonetary default because a cure is not required.

Common sense dictates that the failure to deliver certain items is a quintessential example of a nonmonetary default. The Debtor was not required to make any payments. Indeed the money was to flow from Eagle and Newark to the Debtor. Therefore there are no cure claims to be satisfied before assumption and assignment of the leases. At best there are only claims for whatever damages Eagle and Newark can demonstrate flowed from the delivery of loaner items in place of the scheduled items. These claims need to be addressed in the context of an evidentiary hearing at which the parties will have to introduce evidence as to the claims and defenses thereto, including the circumstances surrounding the delivery of the Certificates of Acceptance.

Appendix C

Conclusion

For the foregoing reasons, the objections to the requests for cure claims [#948] are sustained and the requests for cure claims [#850 and #851] are denied. The parties are free to pursue whatever claims, counterclaims, and defenses they have in a non-bankruptcy court of competent jurisdiction.

Dated: December 11, 2001

s/_____
Joel B. Rosenthal,
United States Bankruptcy Judge

APPENDIX D — RELEVANT PORTIONS OF THE CLAREMONT DECISION IN THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT FILED MAY 12, 1997

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

No. 95-56527, No. 95-56589

May 12, 1997, Filed

In re: CLAREMONT ACQUISITION CORPORATION, INC.; WORTHINGTON; CAL WORTHINGTON DODGE, INC.;

MERHIGE, Senior District Judge:

Appellants Cal Worthington & Cal Worthington Dodge, Inc. ("Worthington") and Debtors, a group of commonly owned automobile dealerships in the Claremont Auto Center ("Debtors"), appeal an order of the district court which reversed an order of the bankruptcy court compelling Appellee General Motors Corporation ("GM") to accept assignment of Debtors' franchise agreements to Worthington. GM has filed a cross-appeal regarding an issue upon which it was unsuccessful in the courts below. For the reasons which follow, we affirm.

FACTS AND PROCEDURAL HISTORY

Debtors operated Cadillac, Pontiac/GMC Truck, Ford, Isuzu and Hyundai dealerships at the Claremont Auto Center in Claremont, California. On or about November 7, 1994,

Debtors ceased operating their automobile dealerships. On November 20, 1994, Debtors commenced a Chapter 11 bankruptcy proceeding. On March 31, 1995, the bankruptcy court approved Worthington as the purchaser of the Debtors' assets, including the dealer franchises. Applying California Vehicle Code § 11713.3(e), which prohibits transfer of an automobile franchise agreement without the consent of the manufacturer whose consent may not be unreasonably withheld, the bankruptcy court required the consent of GM prior to ordering the assignment of the franchise agreements to Worthington. GM refused to consent to the assignment, prompting Debtors to seek an order compelling the assignment. After hearing argument, the bankruptcy court entered an order finding that GM had unreasonably withheld consent within the meaning of Cal. Veh. Code § 11713.3(e). The bankruptcy court therefore ordered GM to accept the assignment of Debtors' GM Dealer and Service Agreements (the "GM Dealer Agreements") from the Debtors to Worthington. The bankruptcy court also ruled that pursuant to § 365(b)(2)(D) of the Bankruptcy Code (the "Code"), Debtors were not required to cure any nonmonetary defaults in order to assume and assign their contracts to Worthington.

GM appealed the order compelling assignment of the GM Dealer Agreements. The district court found that the bankruptcy court had misapplied Cal. Veh. Code § 11713.3(e) and reversed the bankruptcy court's order as it applied to *GM. In re Claremont Acquisition Corp.*, 186 B.R. 977, 986-87. (C.D. Cal. 1995). The district court affirmed, however, the bankruptcy court's interpretation of § 365(b)(2)(D). Id. at 989-90. Worthington and Debtors now appeal the district court's decision with respect to the

application of § 11713.3(e) to the assignment. GM has filed a cross-appeal challenging the district court's interpretation of § 365(b)(2)(D).

II

STANDARD OF REVIEW

This court reviews the district court's decision on an appeal from a bankruptcy court *de novo*. *Daily v. Federal Deposit Insurance Corp. (In re Daily)*, 47 F.3d 365, 367 (9th Cir. 1995); *Siragusa v. Siragusa (In re Siragusa)*, 27 F.3d 406, 407 (9th Cir. 1994) (per curiam). The court independently reviews the bankruptcy court's decision and need not give deference to the district court's determinations. *Robertson v. Peters (In re Weisman)*, 5 F.3d 417, 419 (9th Cir. 1993). We review the bankruptcy court's interpretation of applicable law *de novo*, and the findings of fact for clear error. *500 West INA Road Trust v. Tucker (In re Tucker)*, 989 F.2d 328, 330 (9th Cir. 1993).

III

DISCUSSION

A. Assignment of the GM Dealer Agreements

California law restricts an automobile franchisee's ability to assign the franchise without the consent of the manufacturer. Section 11713.3 of the California Vehicle Code provides:

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> It is unlawful and a violation of this code for any manufacturer, manufacturer branch, distributor, or distributor branch licensed under this code to do any of the following:
>
> . . .
>
> (e) To prevent, or attempt to prevent, a dealer from receiving fair and reasonable compensation for the value of the franchised business. There shall be no transfer or assignment of the dealer's franchise without the consent of the manufacturer or distributor, which consent shall not be unreasonably withheld.

Cal. Veh. Code § 11713.3.

The bankruptcy court held that § 11713.3(e) applied to the assignment of the GM Dealer Agreements to Worthington.[1] On appeal, Worthington argues that the bankruptcy court erred in applying this statute because § 365(f)(1) of the Code does not permit courts to look to state laws prohibiting the assignment of executory contracts. 11 U.S.C. § 365(f)(1). Worthington argues that the bankruptcy court should not have inquired whether GM's refusal to consent was "reasonable" under California law, but should

1. Although it is technically more accurate to speak of the assignment of a party's rights under a contract and the delegation of a party's duties, this opinion follows the more common use of the term "assign" as encompassing both the assignment of rights and the delegation of duties. *See Everex Systems, Inc. v. Cadtrak Corp. (In re CFLC, Inc.)*, 89 F.3d 673, 676 n.2 (9th Cir. 1996).

have instead inquired whether Worthington had given GM "adequate assurance of future performance" as required by § 365(f)(2)(B). 11 U.S.C. § 365(f)(2)(B).[2] Federal courts have struggled with interpreting the Bankruptcy Code provisions governing the assignment of executory contracts. Section 365(f)(1) of the Code provides a general rule which permits a trustee in bankruptcy to assign an executory contract:

> Except as provided in subsection (c) of this section, notwithstanding a provision in an executory contract or unexpired lease of the debtor, or in applicable law, that prohibits, restricts, or conditions the assignment of such contract or lease, the trustee may assign such contract or lease under paragraph (2) of this subsection [requiring adequate assurance of future performance].

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2. Section 365(f)(2) provides:

> The trustee may assign an executory contract or unexpired lease of the debtor only if –
>
> (A) the trustee assumes such contract or lease in accordance with the provisions of this section; and
>
> (B) adequate assurance of future performance by the assignee of such contract is provided, whether or not there has been a default in such contract or lease.

11 U.S.C. § 365(f)(2).

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11 U.S.C. § 365(f)(1). Subsection (c) of § 365 contains an important exception to this assignability rule:

> The trustee may not assume or assign any executory contract or unexpired lease of the debtor, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties, if –
>
> (1)(A) applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to an entity other than the debtor or the debtor in possession, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties.

11 U.S.C. § 365(c)(1)(A).

Section 365(f)(1) appears to *authorize* a trustee to assign an executory contract, notwithstanding any contrary provision in the contract or in applicable law, provided that adequate assurance of future performance by the assignee is provided. Section 365(f)(1), explicitly states, however, that it applies except as provided in subsection (c) of § 365. Subsection (c), in turn, *prohibits* an assignment of an executory contract if applicable law excuses the non-debtor party from accepting performance from the assignee. What § 365(f)(1) appears to give, § 365(c)(1)(A) seems to take away.

Recently, in *In re CFLC*, 89 F.3d 673 (9th Cir. 1996), this court recognized the apparent conflict between

subsections (f) and (c), and noted that this conflict has lead to two different constructions of § 365 and the meaning of the phrase "applicable law" in both subsections. *Id.* at 676-77 (comparing *In re Pioneer Ford Sales*, 729 F.2d 27, 29 (1st Cir. 1984), with *Rieser v. Dayton Country Club Co. (In re Magness)*, 972 F.2d 689, 695 (6th Cir. 1992)). The *CFLC* court did not find it necessary to resolve this conflict, however, because assignment of the patent at issue in that case was barred under either construction of the statute. Likewise, in the instant case, we find it unnecessary to address this matter because resolution of the conflict will not result in the assignment of the GM Dealer Agreements. Instead, we find that the issue raised by GM's cross-appeal, regarding the proper interpretation of § 365(b)(2)(D), is dispositive of this appeal.

IV

GENERAL MOTORS' CROSS-APPEAL

A. Background

On or about November 7, 1994, Debtors ceased operating their automobile dealerships. The bankruptcy cases were not filed until November 20, 1994. The GM Dealer Agreements provided that GM may terminate the franchise for the failure to operate the business for seven consecutive business days. [3]

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3. Article 14.5 of the GM Dealer Agreement provided:

> If [GM] learns that any of the following has occurred, it may terminate this Agreement by giving Dealer written notice of termination. Termination will be effective on the date specified in the notice.

(Cont'd)

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Debtors' failure to operate the dealership for two weeks preceding the bankruptcy filing constituted a nonmonetary default. Moreover, this default is a "historical fact" and, by definition, cannot be cured. *See Lee West Enterprises*, 179 B.R. 204, 208 (Bankr. C.D. Cal. 1995).

In general, a debtor must cure all defaults, both monetary and nonmonetary, prior to the assumption and assignment of an executory contract. 11 U.S.C. § 365(b)(1). However, § 365(b)(2) sets forth an exclusive list of the monetary and nonmonetary breaches that a debtor need not cure before assuming and assigning a contract. 11 U.S.C. § 365(b)(2)(A)-(D). Worthington argued below that, pursuant to subsection (D) of § 365(b)(2), its default does not preclude assignment of the GM Dealer Agreements. The bankruptcy court agreed with Worthington and held that § 365(b)(2)(D) relieved Debtors of their obligation to cure their default. In its cross-appeal, GM contends that subsection (D) does not apply to this case, and that Debtors' incurable nonmonetary default – the failure to operate the dealerships – precludes assignment of the GM Dealer Agreements.

(Cont'd)

. . .

> 14.5.3 – Failure of Dealer to conduct customary sales and service operations during customary business hours for seven consecutive business days.

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B. Construction of § 365(b)(2)(D)

Section 365(b)(2) of the Code provides:

> Paragraph (1) of this subsection [imposing the requirement of curing defaults prior to assumption and assignment] does not apply to a default that is a breach of a provision relating to –
>
> . . .
>
> (D) the satisfaction of any penalty rate or provision relating to a default arising from any failure by the debtor to perform nonmonetary obligations under the executory contract or unexpired lease.

11 U.S.C. § 365(b)(2)(D). Both GM and Worthington argue that the language of subsection (D) is unambiguous, but are at opposite poles as to its meaning. Worthington asserts that under subsection (D), it is not required to cure nonmonetary defaults. GM, on the other hand, reads subsection (D) as stating that, in curing defaults concerning nonmonetary obligations, the Debtor does not have to cure any penalties arising from a nonmonetary default.

The bankruptcy court adopted Worthington's construction of subsection (D). Accordingly, the court held that Worthington's failure to operate the dealerships was a breach of a "provision relating to a default arising from [a] failure of the debtor to perform [a] nonmonetary obligation," which, according to subsection (D), was a default that did

not have to be cured before assumption and assignment. We review the bankruptcy court's construction of the statute *de novo*. *Tucker*, 989 F.2d at 330.

The difference between the parties' interpretations of § 365(b)(2)(D) centers on the effect of the word "or" in subsection (D). Worthington argues that the word "or" operates to create two distinct and independent exceptions to the cure requirements of paragraph (1). Worthington apparently reasons that the clause preceding the word "or" excepts "satisfaction of any *penalty* rate" from the cure requirements, and that the clause following "or" is a catch-all provision excepting from cure *any* "nonmonetary obligations."

GM disagrees with this interpretation of the statute. GM argues that the word "penalty" in subsection (D) modifies *both* "rate" and "provision." Because the provision of the GM Dealer Agreement at issue in this case is not a penalty provision, *i.e.*, a liquidated damage provision, GM contends that the subsection (D) exception does not apply and the GM Dealer Agreements may not be assigned.

We find the construction offered by GM to be the more reasonable interpretation of the statute. A proper reading of subsection (D) requires that the adjective "penalty" modify *both* the words "rate" and "provision," not just the word "rate." Furthermore, like the word "penalty," the word "satisfaction" must also define both "rate" and "provision." Stated differently, subsection (D) provides an exception from cure for satisfaction of "penalty rates" and "penalty provisions." When construed in this manner, the clause

following the word "or" is not a catch-all exception to paragraph (1), but instead an exception concerning those provisions of a contract which impose a penalty for a debtor's failure to perform a nonmonetary obligation.

The proper construction of § 365(b)(2)(D) is readily apparent upon consideration of how the statute would read if the word "or" connected two distinct exceptions, as Worthington suggests. If this were the case, one should be able to delete the first clause, and the statute would still make sense. The statute would read as follows:

> Paragraph (1) of this subsection does not apply to a default that is a breach of a provision relating to – (D) . . . provision relating to a default arising from any failure by the debtor to perform nonmonetary obligations under the executory contract or unexpired lease.

This construction of the section is both grammatically incorrect and nonsensical. The more logical construction of subsection (D) would have the words "satisfaction" and "penalty" relate to both "rate" and "provision." Under this construction, the statute reads as follows:

> Paragraph (1) of this subsection does not apply to a default that is a breach of a provision relating to - (D) the satisfaction of any penalty rate or [*the satisfaction of any penalty*] provision relating to a default arising from any failure of the Debtor to perform nonmonetary obligations under an executory contract of unexpired lease.

Unlike Worthington's construction, this construction is grammatically correct.

GM's interpretation of § 365(b)(2)(D) is further supported by consideration of the general structure of § 365 which suggests that Congress intended subsection (D) to address a single issue: the payment of penalties. In each instance that Congress added a separate or independent exception to § 365(b)(1), it created a separate subclause in § 365(b)(2). The bankruptcy court's interpretation, however, requires a deviation from that general construction principle, as it results in a single subclause containing two completely different and unrelated exceptions. Furthermore, if subsection (D) is a catch-all provision, as Worthington contends, then subsections (A) through (C) of § 365(b)(2) would be superfluous, as they would be encompassed by subsection (D). Conversely, applying the terms "satisfaction" and "penalty" to both clauses in subsection (D) unifies the single provision. The first clause addresses penalty rates which are commonly imposed where a debtor's breach was monetary in nature. The second clause addresses the payment of penalties under liquidated damage provisions where the debtor's breach was nonmonetary in nature.

Finally, the limited legislative history of § 365(b)(2)(D) supports GM's construction of the section and suggests that Congress intended only to relieve debtors of the obligation to pay penalties. The House Report to the Bankruptcy Reform Act provides:

> Section 365(b) is clarified to provide that when sought by a debtor, a lease can be cured at a

> nondefault rate (i.e., it would not need to pay penalty rates).

5 *U.S. Congressional & Administrative News* at 3357 (1994) (H.R. No. 103-835 (1994))(parenthetical in original). By only referring to the payment of penalties, this legislative history lends weight to GM's construction of subsection (D).

Under the interpretation we adopt today, the § 365(b)(2)(D) exception does not apply to Debtors' default. Debtors' failure to operate the franchises for seven consecutive days is not a default of a contractual provision relating to the satisfaction of a penalty rate or the payment of a penalty. Accordingly, Debtors' obligation to cure their default is not excused. Because Debtors are unable to now cure their default, the GM Dealer Agreements may not be assumed and assigned.

V

CONCLUSION

We find that the bankruptcy court erred in its interpretation of § 365(b)(2)(D), and that this section does not relieve Debtors of their obligation to cure their default. Because this default cannot now be cured, the GM Dealer Agreements cannot be assumed and assigned under 11 U.S.C. § 365(b). The decision of the district court is therefore affirmed.

APPENDIX E — STATUTE AT ISSUE

§ 365. Executory contracts and unexpired leases

(a) Except as provided in sections 765 and 766 of this title and in subsections (b), (c), and (d) of this section, the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor.

(b)(1) If there has been a default in an executory contract or unexpired lease of the debtor, the trustee may not assume such contract or lease unless, at the time of assumption of such contract or lease, the trustee—

> (A) cures, or provides adequate assurance that the trustee will promptly cure, such default;
>
> (B) compensates, or provides adequate assurance that the trustee will promptly compensate, a party other than the debtor to such contract or lease, for any actual pecuniary loss to such party resulting from such default; and
>
> (C) provides adequate assurance of future performance under such contract or lease.

(2) Paragraph (1) of this subsection does not apply to a default that is a breach of a provision relating to—

> (A) the insolvency or financial condition of the debtor at any time before the closing of the case;
>
> (B) the commencement of a case under this title;
>
> (C) the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement; or
>
> (D) the satisfaction of any penalty rate or provision relating to a default arising from any failure by the debtor to perform nonmonetary obligations under the executory contract or unexpired lease.

(3) For the purposes of paragraph (1) of this subsection and paragraph (2)(B) of subsection (f), adequate assurance of future performance of a lease of real property in a shopping center includes adequate assurance—

> (A) of the source of rent and other consideration due under such lease, and in the case of an assignment, that the

financial condition and operating performance of the proposed assignee and its guarantors, if any, shall be similar to the financial condition and operating performance of the debtor and its guarantors, if any, as of the time the debtor became the lessee under the lease;

(B) that any percentage rent due under such lease will not decline substantially;

(C) that assumption or assignment of such lease is subject to all the provisions thereof, including (but not limited to) provisions such as a radius, location, use, or exclusivity provision, and will not breach any such provision contained in any other lease, financing agreement, or master agreement relating to such shopping center; and

(D) that assumption or assignment of such lease will not disrupt any tenant mix or balance in such shopping center.

(4) Notwithstanding any other provision of this section, if there has been a default in an unexpired lease of the debtor, other than a default of a kind specified in paragraph (2) of this subsection, the trustee may not require a lessor to provide services or supplies incidental to such lease before

assumption of such lease unless the lessor is compensated under the terms of such lease for any services and supplies provided under such lease before assumption of such lease.

11 U.S.C. § 365.